Market Commentary

PORTLAND INVESTMENT COUNSEL™

January 14, 2013

News Highlights on Current Holdings

Financial Services Companies

US Financial settlements: Further substantial fines paid out last week by US banks, with Bank of America paying $11.6bn to Fannie Mae in compensation for bad loans and separately 10 US banks / mortgage lenders including Bank of America, Wells Fargo, JPMorgan Chase and Citigroup paying more than $8.5bn to settle regulators claims that they were guilty of widespread abuse of the foreclosure system. that allowed banks to seize homes from defaulting borrowers (Bank of America details below)

Bank of America, last week announced three important milestones: (1) resolving substantially all rep and warranty claims and exposures between Legacy Countrywide + Legacy Bank of America and Fannie Mae (which should reduce future "rep and warranty provisions" and tail risks), (2) signing a definitive agreement to sell servicing rights on 2 million residential mortgage loans (which should accelerate the reduction of expenses tied to servicing loans), and (3) taking a $2.5b charge to settle foreclosure review matters and end the process of individual foreclosure reviews (which should reduce the drag of "look back" and other environmental expenses). Questions will remain around how quickly the company can deliver big net reductions in consolidated expenses, as with estimates of significant expense reductions ($13b over 2013-2014). More details as follows:

1. The settlement with Fannie Mae eliminates a chunk of legal uncertainty, and should reduce the drag on profits from putback provisions. The settlement addresses 2000-2008 mortgage issuance from both legacy Countrywide and legacy Bank of America that was sold directly to Fannie Mae ($1.4t issuance, $300bn left after principal pay downs). Bank of America will make a $3.6bn cash payment to Fannie and also repurchase $6.75b in certain residential mortgage loans, though much of this will be satisfied by existing reserves (but still requiring an additional $2.5b putback provision in 4Q12). Assuming a 50% loss severity on these repurchases implies a total settlement cost of ~$7b. It's estimated this implies a cost as a percentage of original issuance of 2% which is on par with its pending private label settlement with investors represented by Gibbs & Bruns but well in excess of the ~0.8% in its settlement with Freddie Mac. This leaves BofA's private label putback exposure—and the pending decision in the proposed Gibbs & Bruns settlement (scheduled for a May 2013 decision)--as the big remaining question mark on the putback/tail risk side. The company updated its estimate of potential putback losses "in excess of existing accruals" to "up to $4b" post the settlement, from "up to $6b" prior, which suggests to us that the company was prepared for an additional $2b accrual for the Fannie Mae settlement and instead agreed to a deal requiring the additional $2.5b provision they will take this quarter.

2. The company announced it signed definitive agreements to sell mortgage servicing rights on 2m loans, of which 232k loans are 60+ days delinquent, and that over time it will realize a $650m gain on the sale (half in 4Q, the rest in 2013 as the servicing assets are transferred). As of 3Q12, the company's cost base included ~$12b annualized operating expenses related to servicing of 936k delinquent loans, and the elimination of 232k of these delinquent loans will help management move toward its ultimate goal of reducing the number of delinquent loans to ~250k and the annual costs associated with servicing them to ~$2bn. Bank of America had already reduced the number of delinquent loans serviced from 936,000 as of 30th September to 775,000 at December 31st, a 17% decline that was also faster than the 12% q/q decline in delinquent loans that it saw between the 2nd and 3rd quarters. As today's announced mortgage service rights (MSR) sale phases in throughout 2013, it should help drive the delinquent loan count to below 500k by year-end 2013, which is a notably faster pace than previously expected. In terms of cost-save timing, because the MSR is gradual throughout 2013, we don't expect it to materially accelerate 2013 cost savings but It should noticeably accelerate BofA's ability to reduce servicing expenses in 2014.

3. In addition, Bank of America announced it will also take a $2.5b charge to settle the regulatory review of foreclosures, as well as for litigation and other mortgage-related matters. For all banks, the foreclosure settlement

and associated payments will effectively replace the costly and time-consuming case-by-case compensation strategy that banks were pursuing, which effectively pulls forward future environmental costs. It was estimated that these “look back expenses” were costing Bank of America ~$500m per year, and this expense will now essentially be eliminated.

Aviva - Are to sell their remaining stake in Delta Lloyd in a private placement. Management had previously flagged that they would sell down to zero when the opportunity arose. Aviva owned 34.3m shares which were being offered by ABO at a range of €12.15 - €12.65. It priced at top of the range €12.65. They are currently carrying it as an associate and they marked-to-market the value on the books recently. The transaction is expected to boost Aviva’s economic capital surplus coverage ratio by ~4% to 169% which is at the upper end of their targeted range.

BNP Paribas/Societe Generale/ Deutsche Bank- Financial Times reports the Fed is weighing a plan to allow foreign banks to avoid costly regulatory changes. The Lincoln amendment to the Dodd-Frank deal prohibits banks from acting as derivative dealers if they have access to deposit insurance, as this was deemed as subsidising their trading activities. However, no exception was extended to the US branches of foreign banks like BNP, Soc Gen and Deutsche. They would be forced to endure a costly move of all derivative trading out to an affiliate in what is called a ‘swaps push out’ rule and increase their cost of funding. The Fed however, are now looking to consider treating foreign banks’ US branches as separate legal entities, so one branch of a foreign bank could continue to have access to the Fed discount window while another branch act as a swaps dealer. The rule to push out swap trading is to take effect July 2013.

Credit Suisse - announced last week that it has signed an agreement to sell its ETF business to BlackRock. The sale is part of Credit Suisse’s strategic divestment plans that were announced on July 18, 2012. It comprises Credit Suisse’s ETF business with assets under management of CHF16.0bn as of November 30, 2012. The transaction is subject to customary closing conditions, including regulatory approvals and is expected to complete by the end of the second quarter of 2013. The terms of the deal are not being disclosed.

Intesa placed a dual-tranche $3.5bn bond with US investors – the largest senior debt placement by an Italian financial issuer on the US$ market and the largest public issue by a European financial issuer on the US$ market since January 2011. The order book of approximately US$11bn is almost 6 times the benchmark size initially indicated to the market by ISP for the two issues. The average pricing in Euro is equivalent to approximately mid swap + 2.3%, ie, no extra premium over the cost of similar issues on the Euro market.

Santander - the boards of Banco Santander and Banesto have approved the merger plans. Santander is to offer 0.633 own shares per each Banesto share. Note, Santander is to buy all of Banesto and shut 700 branches in Spain.

Santander - Reuters reports that Santander has received Chinese regulatory approval to operate as an independent car financing company, one of the first foreign banks to get a car finance licence in the world’s largest auto market. Santander will operate through its Fortune joint venture, set up in December 2011, in a 50-50 tie-up between its consumer finance unit and China’s seventh biggest car manufacturer, Jianghuai Auto (JAC) 600418. SS, the bank said on Sunday. Fortune Auto Finance will have initial capital of 500mn yuan ($80.4 million). Its loans will not be restricted to JAC’s products. It is estimated that 19 million cars were sold in 2012 in China, compared to around 14 million in the United States, and double-digit growth expected to continue in coming years. Separately, Handelsblatt carries an article suggesting Santander’s German division profits rose 40-45% last year to around €335mn, citing the German chief Ulrich Leuschner. He expects a “slight growth in proceeds” this year.

Wells Fargo; 4th quarter results of Earnings per share of $0.91 beat expectations of about$0.89. Deducting special items that management called out, (above-average quarterly equity gains +$0.05, mortgage foreclosure settlement charge of -$0.09, charitable foundation contribution -$0.03, and tax gain of +$0.06), adjusted

EPS looked closer to $0.92. The company reported group revenue of $22.1b with net interest income of $10.84b which was flat q/q. However the net interest margin fell 0.10% to 3.56%. Management attributed 8bps of the net interest margin decline to strong deposit inflows (+$34b q/q), 5bps to continued balance sheet re-pricing, partially offset by 3bps help from higher variable sources. The deposit growth, as well as retained mortgage assets, pushed earning assets higher. Loan growth was a positive, with total loans up $17.0b (+9b commercial, +$8b consumer), aided by another $9.7b of retained mortgage production. Fee income of $11.31b was driven by stronger than expected mortgage production revenues and also ~$393m of

"above average equity gains". Stripping out these equity gains implies adjusted fee income closer to $10.91b. Other bright spots include the brokerage business (fees up ~8% q/q). The company demonstrated its ability to digest a number of regulatory settlements and other environmental pressures and still come in ahead on EPS while posting an Return on assets of 1.46% and an Return on equity of 13.4%. While the low-rate environment continues to pressure the net interest margin, we believe Wells Fargo has profit levers from expenses, credit, capital management and deposit/loan balances that continue to expand earnings. On a Basel III basis, Tier 1 Capital grew ~0.16% to an estimated 8.18% which puts the bank in good shape to continue to return capital in 2013 assuming its plan is approved during the Fed's 2013 CCAR test.

Dividend Payers

Bayer – Announced it had received the regulatory approval from the US Federal Trade Commission to complete the acquisition of the US based animal health business of Teva Pharmaceutical. Bayer will pay up to $145mm, which includes an upfront payment of $60mm plus a total of $85mm in milestone payments, which are linked to the successful and timely achievement of manufacturing and sales targets. This acquisition fits well with Bayer HealthCare division strategic goals of increasing its exposure to the animal care market.

Nestle – is reported to have hired Rothschild to advise on the sale of a number of assets related to its acquisition of Pfizer's baby food business for $11.85Bn in the spring of 2012. As part of the adjustments needed to win regulatory approval for its purchase, the group might have to sell up to 30% of the Pfizer businesses, including some in Latin America, the Middle East and Asia. The process is likely to take up to 12 months and companies interested in picking up the assets include Mead Johnson, Heinz and Danone.

Seven&i – The Japanese convenience store giant, whose assets include the 7-Eleven stores, reported an operating profit of ¥69.2Bn for the third quarter of its fiscal year, an increase of 4.8%Higher profits from its core 7-Eleven stores were supported by stronger income results at other retail formats, such as Ito-Yokado general merchandise stores and York-Berimaru supermarkets. The company is fighting lower levels of growth at home in an environment of persistent deflation and falling population. In response its Japanese convenience stores have increased the variety of their merchandise, including adding cooking oils, fresh vegetables and lower-priced, private-brand items, in an effort to attract non-traditional customers like the elderly. Also, to offset the lower domestic growth, Seven&i is working to expand its US convenience network, looking to add more than 600 stores in the world's biggest consumer market this fiscal year. The group increased its annual dividend forecast to ¥64 per share from an earlier estimate of ¥62 per share.

Tesco – provided an update on its UK trading over the Christmas period, turning out the highest sales growth in three years over the holidays. The UK like for like sales, excluding fuel and value added sales tax, grew 1.8% in the six weeks to January 5, part of the firm's fiscal fourth quarter, ahead of the consensus expectations for a 0.5% to 1.5% improvement. The growth was driven by a stronger food performance and an 18% rise in online food sales, offset somewhat by slower sales of general merchandise, including electricals. The group has been battling to regain momentum in a weak UK economy, as consumers are adjusting to the austerity measures. A £1Bn turnaround plan for Tesco's home market, launched last year, includes investing in more staff, revamped food ranges, refined marketing and revamped stores that give more space to food. Tesco also announced the appointment of Chris Bush, a Tesco lifer, as a managing director to run its British business. The division had been run by Tesco's CEO, Phil Clarke, since the departure of Richard Brasher in March of last year.

Vivendi – will appeal a US court ruling in a Liberty Media suit, which confirmed a €765mm jury verdict rendered against Vivendi last year. The case pertains to the acquisition of USA Networks by Vivendi from Liberty media in 2001. Vivendi strongly believes that it did no wrong and intends to pursue its appeal to the fullest extent possible.

Economic Activity, Consumer and Business Conditions

US – A relatively light macro-economic news week was punctuated by an unexpected broadening of the US international trade deficit, which reached $48.7Bn in November, contrary to the expectations, which were calling for a contraction of the deficit to a $41.3Bn level from October's $42.1Bn read. The deficit growth was driven by a 3.8% increase in imports, in the run-up to the holidays shopping season, while exports only improved by 1%. Given the above, the US net exports are more likely to detract from the fourth quarter GDP growth.

The US consumer has continued to add to its debt burden as consumer credit growth accelerated in November, up $16Bn, ahead of the expectations for a $12.8Bn increase, and on top of October's $14Bn advance.

Canada –The Canadian balance of visible goods trade deficit widened unexpectedly, reaching $1.96Bn in November, ahead of the expectations for a flattish showing at negative $600mm. Imports gained 2.7% in the month, while exports retreated by 0.9%, dragged by a slow-down in exports of agricultural commodities and metals. Same as in the US, the Canadian net exports seem to be a net detractor to economic growth in the fourth quarter.

On the Canadian housing front, the numbers issued last week clearly show a cooling market. The Canadian housing starts retreated 1.7% in December, to 198,000 units annualized, albeit ahead of the consensus expectations, which were calling for a 195,000 annualized level. The pull-back was led by the multi-unit starts, offset somewhat by growth in the single-unit starts. The building permits dropped 17.9% in November, erasing the 15.9% advance in October, while overshooting on the expectations which were calling for a 7.6% retreat. New housing prices continue to grow, up 0.1% in November, although it decelerate from October, when prices advanced by 0.2%, underlying hopes that the Canadian housing market might see a soft landing.

Financial Conditions

Bank of England as expected left rates unchanged.

European Central Bank held rates steady at 0.75% and announced no new policy measures, as expected. In his opening statement, ECB President Draghi reiterated that inflation is projected to fall below 2% this year, with broadly balanced risks to the outlook. He remains downbeat on the growth outlook with economic weakness expected to extend into 2013. Not surprisingly, economic risks remain on the downside. The ECB is expecting the economy to recover gradually "later in 2013" due to easy monetary policy and improved confidence.

Spain – the Spanish government's benchmark 10-year borrowing cost fell below 5% last week for the first time in 10 months after Madrid successfully initiated an ambitious Euro 71 billion funding program for 2013…by selling Euro 5.82 billion of debt which subsequently traded at 4.9%.

US – UK: US Federal Reserve policymakers remain determined to flatten the yield curve as much as possible, having indicated they expect 'exceptionally low levels of interest rates until the unemployment rate falls below 6.5% (December 7.8%) which is likely to be through 2014. Fed Reserve Chairman, Ben Bernanke has indicated 1% or less would be considered exceptionally low. In September 2012, the Fed announced it would buy $40 bn per month of agency mortgage-backed securities and in December 2012 that it would also buy $45 bn per month of treasuries (4 year maturity and above) which means all parts of the yield curve will benefit from a near-zero anchor until late 2014. The U.S. 2 year/10 year treasury spread is now 1.60% and the

U.K.'s 2 year/10 year treasury spread is 1.66% - meaning investment banks can no longer profit from a steep yield curve and instead are seeking operational efficiencies, including job cuts and lower compensation, to maintain acceptable levels of profit, i.e. above their costs of capital. It seems the top tier 8-10 investment banks will continue to command their market and possibly increase their share – as barriers to entry for newcomers have in our view been raised.

Influenced by the US 'twist', the U.S. 30 year mortgage market remains very low at 3.40% - (3.31%, end of November the lowest rate since the Federal Reserve began tracking rates in 1971), as the Federal Reserve effectively continues to give priority to incentivising home ownership. Existing U.S. housing inventory is at 4.8 months supply of existing houses. So the combined effects of record low mortgage rates, near record high affordability, a more promising economic recovery, job creation, and low prices are finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months. A recovery in house prices appears increasingly sustainable as a result of the Fed actions – which is welcomed….particularly for those financial services companies holding such assets in their portfolios.

A concern which is easing is the extent to which mortgage foreclosures have been properly documented, thereby enabling mortgages to be "put back" to the originating bank and whether bank's have mis-represented the quality of those assets sold to Freddie Mac and Fannie Mae. Such legal debates are likely to drag on for years but from recent bank investor relations presentations it does seem the rate of "put backs" are now beginning to decline and that litigation reserves should suffice, enabling banks to continue to post increasing earnings per share (as credit improves) over the next 18 – 24 months by when we expect more normalized earnings power to have returned. For the larger franchises the quantum of proactive provisioning continues to act as a differentiator of quality which we believe has still to be fully appreciated.

As concerns have swung from commercial real estate and unsecured consumer loans/credit card loans to European sovereign debts the number of small U.S. banks failing continues to grow, albeit at a more moderate pace with 1 in 2013 (compared to 49 in 2012, 95 in 2011 and 157 in 2010 which was the highest annual tally since 1992). Franchises are being acquired/absorbed as convergence of the financial services industry accelerates – favouring we believe the stronger, better managed banks..

The VIX (volatility index) is 13.65 and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

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Closed-End Funds

Spreads on the closed-end funds are narrowing but remain, in our view, very attractively priced to purchase.

The Portland Investment Counsel Inc. 2009 Closed End Annual Reports are now available on the web site. Below you can find the link to access the closed end annual report.

http://www.portlandic.com/Info.aspx?disp=Financial_Reports

At the close of business on Fridays and at the end of each month we publish the Net Asset Values (NAV) of our funds onto our Portland website at http://www.portlandic.com/Funds/WeeklyPricing.aspx. The NAV for the AIC Global Financial Split Corp. can be found on the AIC/Manulife website at http://www.aic.com/EN/PricePerformance/AICClosedEndFunds/Pages/Price.aspx and the Copernican World Financial Infrastructure Trust, Copernican World Banks Split Inc. and the Copernican International Financial Split Corp. can be found on the Copernican website at http://www.copernicancapital.com/Funds/WeeklyPricing.aspx.

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